SUPREME COURT
OF THE
UNITED STATES

OCTOBER TERM, 1947

No._____

CHICAGO MINES COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

THE LONDON EXTENSION MINING COMPANY,
as Transferee of CHICAGO MINES COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

THE LONDON EXTENSION MINING COMPANY,
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Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, TENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The Petition of Chicago Mines Company, The London Extension Mining Company as transferee of Chicago Mines Company, and The London Extension Mining Company, Colorado corporations, respectfully shows:

SUMMARY AND SHORT STATEMENT OF MATTER INVOLVED.

The petitioners sued in The Tax Court of the United States for a redetermination that would allow percentage depletion deductions from gross income that came from the sale of ores milled and marketed from the dump at their American Mine in Park County, Colorado. The Tax Court ruled in favor of the respondent (R. 9-21; 7 T. C. 1103). On a review by the Circuit Court of Appeals for the Tenth Circuit, the decisions of the Tax Court were affirmed (R. 61-66; 164 Fed. (2d) 785, adv. sheets of Feb. 9, 1948). The present proceeding seeks a review and reversal thereof by this court.

Contrary to the Congressional intention of Sections 23 (m) and 114 (b) (4) of the Internal Revenue Code, Title 26, USCA, the lower court in effect denied the petitioners the right to have a percentage depletion deduction on income from the sale of ores from the mine because such ores had been deposited on the dump at the mine before being hauled to mill and market.

The decision of the court below is contrary to decisions of the Circuit Court of Appeals, 9th Circuit, construing the same sections, in *New Idria Quicksilver Mining Company* v. *Commissioner,* 144 Fed. (2d) 918, and *Commissioner v. Kennedy M. & M. Co.,* 125 Fed. (2d) 388, affirming *Kennedy M. & M. Co.* v. *Commissioner,* 43 BTA 617.

The decision below is also at variance with principles laid down in the recent decisions of this court in *Kirby Petroleum Company* v. *Commissioner* (1946), 326 U. S. 599,

66 S. Ct. 409, 90 L. Ed. 343; *Douglas* v. *Commissioner* (1944), 322 U. S. 275, 64 S. Ct. 988, 88 L. Ed. 1271, and *Herring* v. *Commissioner* (1934), 293 U. S. 322, 55 S. Ct. 179, 79 L. Ed. 389, on the question of an economic interest in mineral property sufficient to support a percentage depletion allowance.

JURISDICTIONAL STATEMENT

The jurisdiction of this court to review the decision of the United States Circuit Court of Appeals, Tenth Circuit, is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, Title 28 U.S.C.A, Section 347 (a), for the following special and important reasons:

(a) The Circuit Court of Appeals by its decision herein has rendered a decision in conflict with the decisions of the Circuit Court of Appeals, Ninth Circuit, in the *New Idria* and *Kennedy* cases, *supra,* on the same question or matter.

(b) The lower court has decided an important question of federal law which has not been, but should be, settled by this court. The application to mine-dump ores of Sections 23 (m) and 114 (b) (4), I.R.C., has not yet been considered or decided by this court.

(c) The court below by its decision herein has decided an important federal question in a way in conflict with applicable decisions of this court in *Kirby Petroleum Company* v. *Commissioner* (1946), *supra, Douglas* v. *Commissioner* (1944), *supra,* and *Herring* v. *Commissioner* (1934), *supra.*

(d) The record presents an important federal question involving the Internal Revenue Code and the legislative policy regarding the production of metals, pertaining to the national interest, which should be reviewed and decided by this court.

(e) The lower court has approved the levy of a federal income tax on capital rather than income, in a manner

contrary to the legislative intention, by denying the right to a depletion deduction allowed for the wasting of a capital asset in the form of a metal mine and natural deposit.

OPINION OF THE COURT BELOW

The case on appeal was heard by Judges Bratton, Huxman and Murrah. The opinion appears at R. 61-66 and is reported in 164 Fed. (2d) 785, advance sheets of February 9, 1948. In apt time, on November 26, 1947, the petitioners filed their petition for rehearing and brief in support thereof (R. 71-80), which petition was denied on January 8, 1948 (R. 125).

QUESTIONS PRESENTED

The questions presented involve the following points raised by the taxpayer:

1. London Extension as fee owner and operator, or as fee owner and lessor of the mine retaining a royalty interest, is entitled to its percentage depletion deduction on income in the taxable year, from ores that had been dug from the mine, regardless of whether they were sold immediately on extraction from the veins or were held for a time on the surface of the mine.

2. London Extension had an indisputable economic interest in the mine, its surface and underground deposits, being a half-owner of all thereof; therefore its right to the depletion allowance was clear, whether it sold dump ores itself, as in C. C. A. No. 3510, or whether it sold them and derived income through its lessee, as in C. C. A. Nos. 3508 and 3509.

3. The true and rational meaning of Sections 23 (m) and 114 (b) is that, where an owner of a mine and its underground deposits causes ore therefrom to be processed and marketed by lessee, the owner does not lose his depletion allowance by the circumstance that the particular lease happens to cover only the dump; because the dump ores came from his mine and were still on the property,

and no depletion has been, or could have been, previously allowed because of the mere breaking out and hoisting of such ores to the surface dump.

4. Only an unjust construction can deprive both owner and lessee of all depletion deduction, simply because the lease in Nos. 3508 and 3509 included the dump and not also the underground mine.

5. Section 23 (m) intends that when the owner and lessor of a mine is afforded a deduction for percentage depletion, such deduction is to be shared with whatever lessee may do the work. This is the intent even in a conventional arms-length relationship of lessor and lessee, where there is not the identity between them that existed at bar. The question of depletion *vel non* is answered in the affirmative if the lessor is an owner of the mine and natural deposit.

6. In C. C. A. Nos. 3508 and 3509, London Extension as transferee, and Chicago Mines Co. (nominally lessee but actually an instrument and *alias* of London Extension, its sole owner and parent) are entitled to deduct percentage depletion in respect to income accrued during the taxable period from ore theretofore placed on the dump from prior working of the mine by the lessee of London Extension.

7. Even if the foregoing points were not well taken in C.C.A. Nos. 3508 and 3509, Chicago Mines Company during its existence and operation, although technically a corporation without a leasehold on the underground deposit, was wholly owned by the mine-owner London Extension, and the real interest was identical. Chicago Mines was an instrument and department of London Extension to work and sell dump ores that came from its mine (R. 8, 48). The mine-owner in fact was measuring the depletion of its mine and natural deposit through the operations of its department Chicago Mines, and the depletion allowance should not be forfeited merely because the lease from the mine-owner to its instrumentality or department embraced only the dump. This situation calls for "a reasonable allowance for depletion * * * according to the

peculiar conditions in each case," prescribed by Section 23 (m); and presents also "a form of legal relationship" under Regulations 103, Sec. 19.23 (m) -1 (as amended by T.D. 5210 Jan. 8, 1943).

8. In C.C.A. No. 3510, London Extension is clearly entitled to deduct percentage depletion in respect of income it derived during the taxable period from its own extraction, sorting, milling and sale of ore *from the dump*, and from the *royalties* it received from Chicago Mines Company.

9. Also in No. 3510, the owner London Extension is clearly entitled to the depletion allowance on income from its own mining of ore *from the underground veins*, its gross income being enhanced in the taxable period by its own working and sale of the dump ores and by its retained or reserved royalties from Chicago Mines Company on the dump ores the latter had worked and sold as lessee; this entire income thus necessarily coming from the mine.

10. Further, the dump ores, as well as the ore newly mined from its underground veins, from which London Extension derived part of its gross income during the taxable period, were all ores from its mine, and the income constituted part of its gross income during the taxable period from a single mining property for purpose of measuring the amount of percentage depletion to which it is entitled. Sec. 114 (b) (4) (A) and (B), and Reg. 103, Sec. 19.23 (m)-1 (b) and (i).

> "Income derived from the ores called tailings, as well as that derived from the newly mined ores, *was income from the mine.*"
>
> *Commissioner* v. *Kennedy M. & M. Co.*, 9th Cir., *supra.*

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

(a) The lower court has construed the Internal Revenue Code, Sections 25 (m) and 114 (b) (4), contrary to decisions of the Ninth Circuit, to-wit:

New Idria Q. M. Co. v. *Commissioner,* 144 Fed. (2d) 918, 921.

Commissioner v. *Kennedy M. & M. Co.,* 125 Fed. (2d) 339, 400, affirming *Kennedy M. & M. Co.* v. *Commissioner,* 43 B.T.A. 617.

(b) The lower court has also construed and applied said sections contrary to the decisions of this Court on the economic interests of taxpayers in a natural deposit subject to depletion.

Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, 66 S. Ct. 409, 90 L. Ed. 343.

Herring v. *Commissioner,* 293 U.S. 322, 55 S. Ct. 179, 79 L. Ed. 389.

Douglas v. *Commissioner,* 322 U.S. 275, 64 S. Ct. 998, 88 L. Ed. 1271.

(c) The decisions of the lower court, and of the Tax Court therein affirmed, have upset and thrown doubt upon the Ninth Circuit decisions cited above that seemed to settle a question very important to the mining industry, all to the discouragement and jeopardy of the important output coming from mine dumps, which dumps contribute greatly to the national supply of metals.

(d) The decisions and opinion below (R. 61, 64-66) introduce new elements and conditions as tests of the right of a mine-owner to have depletion deduction. These tests are not found in the statute or in previous rulings, and are against the prior decisions cited above. Said further tests and conditions announced below are:

(1) That the marketing of dump ore must be "an integrated part of the orginal mining operation" (R. 64): or "an integrated step in a mining operation". (R. 65); and

(2) That the dump must be "created with the accompanying intent to work it at a future time" (R. 66).

These are novel criteria, without definition, and are contrary to the Ninth Circuit decisions. The new phrases quoted have never been weighed, considered or defined, or their oppressive or unworkable implications explored, in reference to depletion of mines, and they introduce confusing restrictions, against the statutory intent and policy.

PRAYER.

Wherefore your petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals, Tenth Circuit, commanding said court to certify and send to this Court the transcript of record in the above-entitled consolidated cause No. 3508, 3509 and 3510 therein, and that the record and judgments of said court be considered and reviewed according to the rules and practice of this Honorable Court, to the end that said cause may be reviewed and determined, and that the judgment of the United States Circuit Court of Appeals, Tenth Circuit, be reversed, and the cause remanded for further proceedings according to law, and that your petitioner have such other and further relief as may to this Court seem just and proper in the premises.

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by FRAZER ARNOLD,
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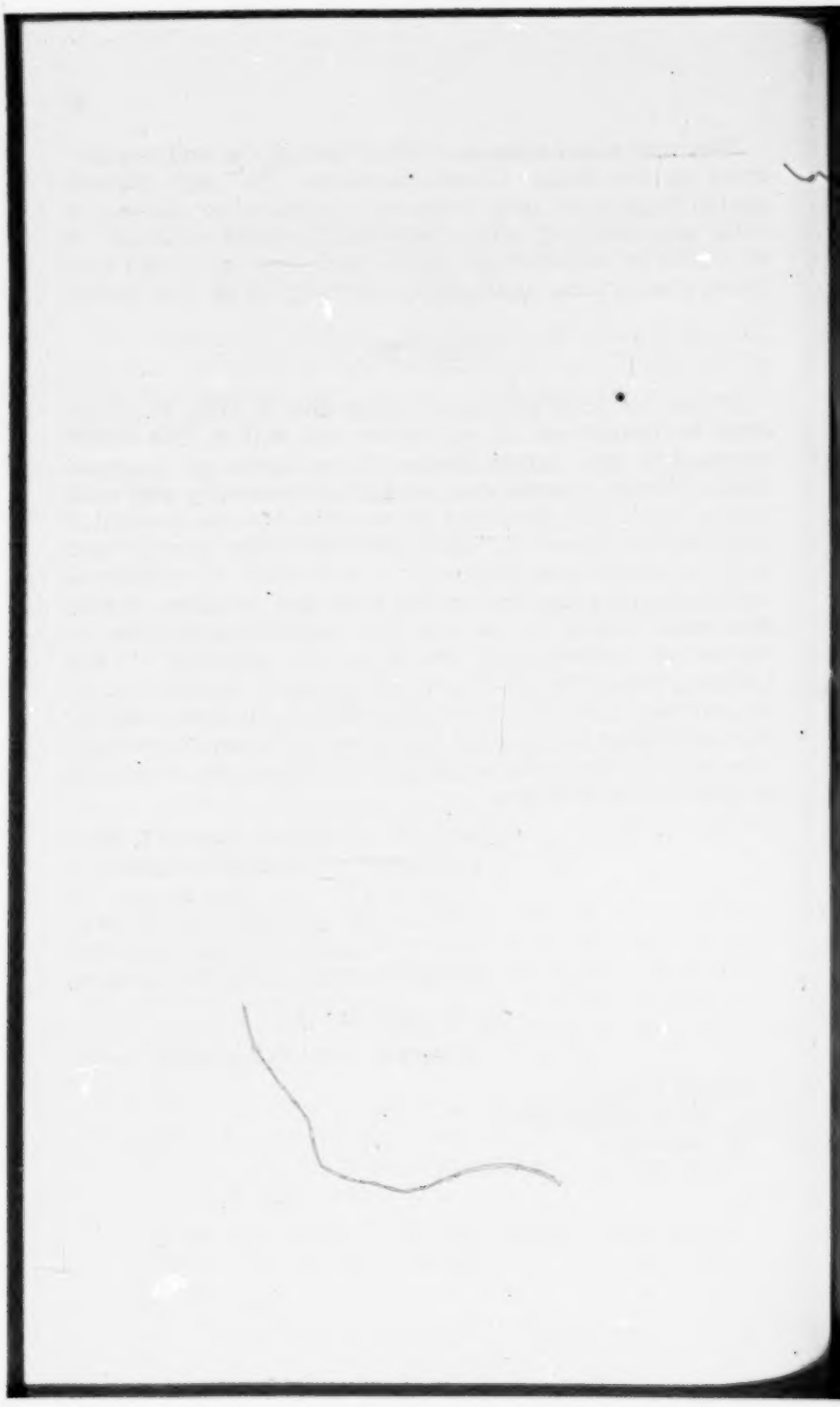

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OPINION OF THE COURT BELOW

The opinion of the Circuit Court of Appeals, Tenth Circuit, dated November 6, 1947, is reported in 164 Fed. (2d) 785, Advance Sheets of February 9, 1948, and may also be found in the record commencing at page 61.

GROUNDS ON WHICH JURISDICTION OF SUPREME COURT OF THE UNITED STATES IS INVOKED

The judgments of the Circuit Court of Appeals, Tenth Circuit, were entered on November 6, 1947 (R. 67-8). Petition for rehearing was denied on January 8, 1948 (R. 125). Petition for writ of certiorari, *supra*.

The judgment of the lower court is based on its construction of the Federal Internal Revenue Code, Title 26, U.S.C.A., Sections 23 (m) and 114 (b) (4) set forth in the Appendix, *infra*. The jurisdiction of the Supreme Court of the United States is invoked under Sec. 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, Title 28, U.S.C.A., Sec. 347 (a).

STATEMENT OF THE CASE.

This proceeding was instituted by petitions in the Tax Court of the United States (R. 1, 29, 42) for a redetermination of the respective deficiencies asserted by the Commissioner of Internal Revenue in his notices of deficiency (see agreements for entry of decisions under Rule 50, R. 22-24, 37, 53-55). The Tax Court held for respondent in the consolidated case on November 7, 1946 (Opinion, R. 9-21), and petitions for review were duly filed in the lower court (R. 25, 37 and 55), resulting in judgments affirming the Tax Court. Petition for Rehearing (R. 69-75) being denied, mandate issued in accordance with the opinion and judgments (R. 125).

The depletion allowance in dispute concerns income derived through sale of ores from the mine dump extending from the collar of the shaft of the American Mine. The petitioner The London Mining Extension Company at all times owned an undivided half interest in the mine (R. 47-8). On June 7, 1940, it had also obtained by assignments all leasehold rights of the previous lessees on the entire ownership (R. 48). The mine consists of the surface and underground workings in the American, Huron, Fraction and Ibex lode mining claims (R. 47-48), shown on the map (R. 51). The other half-interest in the American claim was and is owned by a group called the Ellis heirs, while the other half-owner of the Huron, Fraction and Ibex was and is The London Mines & Milling Company, a corporation having no interrelationship with the petitioner London Extension (R.47). The dump was roughly triangular in shape, extending south from the collar of the shaft near the south corner of the American claim, and lay partially on the American, Huron and Fraction, mostly on the Fraction (R. 48, 51). It had been built up entirely of material from this mine, by underground operations of the former lessees of London Extension and the other co-owners of the mine. (R. 48).

Chicago Mines Company, the wholly owned and held subsidiary of London Extension, was lessee of London Extension to extract and market dump ores from June 10 to October 8, 1940 (R. 48), the income from which operation is involved in C.C.A. No. 3508 and 3509 (R. 7, 8), under a lease dated June 10, 1940 (R. 48). Later all its corporate assets were transferred to its parent company London Extension, and the capital stock held by the parent company and the qualifying shares held by its directors were at that time canceled and surrendered (R. 8, 48). From October 8, 1940 to the end of 1940, the owner London Extension derived further income by its own sale of dump ores which it extracted itself from the dump, while at the same time working underground; this income being involved in C.C.A. No. 3510 (R. 48, 49).

As the result of these operations and income Chicago Mines and its parent company as transferee (London Ex-

tension, the mine-owner) claimed a percentage depletion deduction of $10,150.34, the amount and computation not being disputed (R. 8.), in C.C.A. Nos. 3508 and 3509. And in No. 3510, London Extension claimed depletion, based on its receipt of net smelter returns from its own dump operations during 1940 of $57,014.58, after deducting its marketing and transportation costs; it also claimed the depletion deduction on $16,917.23 royalties from the Chicago Mines dump operations; and further on $22,638.45 net smelter returns from its own underground mining; whereby, in No. 3510, it claims $14,485.54 disallowed depletion (i.e. underground operations $3,395.77, its own dump operations $8,552.19, and dump ore royalties $2,537.58), all undisputed as to computation if allowable (R. 48-49).

SPECIFICATION OF ERRORS

The United States Circuit Court of Appeals, Tenth Circuit, erred:

1. In drawing an artificial distinction, in all three decisions, between ores that had been previously mined and held on the dump and newly mined ores, contrary to Sec. 23 (m) and Sec. 114 (b) (4) (A) and (B).

2. In denying a deduction in C.C.A. Nos. 3508-9, even though Chicago Mines be considered as an ordinary arms-length lessee of the owner, contrary to Sec. 114 (b) (4) (A), which provides that "the allowance for depletion under Sec. 23 (m) shall be * * * in the case of metal mines * * * 15 per centum * * of the gross income *from the property* during the taxable year * * *."

3. In failing to allow the deduction "according to the peculiar conditions in each case," as enjoined in Sec. 23 (m).

4. In counteracting, in Nos. 3508-9, the broad purpose and policy of this legislation, which is to encourage production of metals as well as to allow mine owners a just depletion. The real and only party in interest in this arrangement called a lease (R. 4, Exhibit B), was the mine owner and taxpayer London Extension. As between the mine owner

and its wholly owned subsidiary and operating department Chicago Mines, corporate entities should be disregarded, because the legislative policy to stimulate output of metals is thereby furthered (authorities, *infra.*)

5. In failing to apply the principle, in Nos. 3508-9 and 3510 alike, that income tax is a levy on income and not on capital, and that, where capital was used up in producing income, the depletion deduction was intended.

6. In considering, in No. 3510, that *two separate properties* were involved, one consisting of newly mined ores, and the other of ores previously mined but held on the ground. Hence the erroneous disregard of the fact that income during the taxable year in the combined form of royalties reserved on dump ores, of income from the taxpayer's own dump operations, and of income from its own underground operations, all was income derived from the one mine and natural deposit.

ARGUMENT.

I.

Percentage depletion deductions apply to income from ores dug from a mine, whether the ores are sold immediately or are held for a time on the surface of the property.

The court below drew a complex distinction out of line with reality in mining operations, between income from the marketing of ores newly mined from the veins and of ores that have been piled for a time on the claims. All the dumped metal had come from the one mine. No depletion on income from it had ever been taken or deducted before, nor could it have been previously deducted, in the very nature of percentage depletion allowances, which must await sale and income for their determination. This error is in direct conflict with the realistic, just and practical Ninth Circuit decisions in the *New Idria* and *Kennedy* cases, *supra,* which are hereinafter quoted.

The rulings below were also contrary to broad and liberal principles recently announced by this court, in reference to an economic interest subject to depletion.

Kirby Petroleum Company v. *Commissioner, supra* (1946).

Douglas v. Commissioner, supra (1944),

Herring v. *Commissioner, supra* (1934).

There can be no distinction in substance between dump ores that have been hoisted and dumped on the surface, and the similar broken stope-fill ores that have remained below. The sole difference is that the former are lying in daylight near the top of the shaft, whereas the stope-fill material is piled in darkness underground. It could not be seriously claimed that a delay of a few years or months in hoisting stope-fill ores to the surface and selling them would deprive the owner and his lessee of their depletion allowance. There would be no sounder basis for assuming a present intention to later mill and sell stope-fill than for denying such intention regarding ores placed on a surface dump. In either case, the "present intention" may be only a hope or belief that future conditions, local or general, will sooner or later make milling and sale profitable. But the unalterable fact is that, whenever such ores are sold, and regardless of what may have been supposed about them before, the income therefrom *does* furnish the basis for measuring the statutory percentage depletion and for ascertaining for the first time the depletion that took place in the mine.

II.

Under Sec. 23 (m) and Sec. 114 (b), Chicago Mines and London Extension as transferee are entitled to depletion allowance as lessee, to be equitably apportioned with London Extension as lessor.

When the owner whose mine is depleted selects a lessee as his instrument on the property to extract and market the ore, Section 23 (m) intends that the depletion deduc-

tion shall be apportioned equitably between owner and lessee. It is a clear legislative declaration that when the mine owner becomes entitled to depletion allowance, his deduction is to be shared with whatever lessee may do the work. Sec. 114 (b) (4) (A) authorizes an allowance for depletion of 15% of the gross income from the property, excluding from such gross income an amount equal to royalties paid by the taxpayer in respect of the property. This deduction is limited in amount so as not to exceed 50% of the net income from the property. Where a mining property is leased subject to a royalty to the owner, the lessee deducts from his gross income the royalty paid to the lessor, and the lessee calculates his 15% depletion allowance on the remainder of gross income. The lessor is entitled to deduct 15% of the royalty received by him. Together, then, the lessor and lessee cannot receive more than 15% of the gross income from the property. Such is the apportionment here claimed by the lessee Chicago Mines and the lessor London Extension on the operations of Chicago Mines in C.C.A. Nos. 3508-9. All ore in the dump came from the American Mine. The petitioner London Extension is admittedly the half-owner of the mine, but the respondent and lower court have denied this owner any allowance for the manifest depletion of its mine, merely because its lessee was employed in extracting and marketing ores from the dump and not also and at the same time ores being broken from the veins. So, by these unnatural and unreal refinements, the owner would forfeit its share of the depletion allowance, and so also would its lessee forfeit its share of the deduction, contrary to the statutory scheme and prior decisions. The mine has obviously been depleted, yet both the owner and its lessee which performed the work lose all their depletion allowance by a kind of sleight of hand, despite the fact of depletion in the mine.

This unjust result was reached below because the lease to Chicago Mines covered only the dump and not the underground deposits, and it was held that, although London Extension's underground deposits were depleted and the depletion now measured for the first time by sale of ore and consequent income, said owner must lose its depletion

allowance because of the circumstance that its lessee was engaged only in recovering ores from the dump. We submit that this is an unjust "distinction without a difference." It is against the intention of Congress, which is to allow mine owners a percentage deduction for the depletion of their capital assets. The deduction is to be equitably shared with the lessee doing the work. This is a feature assisting the owner as well as the lessee, because it enables the owner to offer better terms and induce a lessee to undertake operations, and it directly encourages mining activity and the output of metals, which was the underlying policy and intent of Congress. The legislative policy was also fundamentally just and equitable. In allowing percentage depletion Congress permitted mine owners and operators, engaged in production from a wasting asset, to have a deduction from gross income in compensation for the capital loss to the owner incurred by gradual exhaustion of the deposits on which they are working. In short, the income tax is a levy on income and not on capital; and where, in producing the income, capital was used up, some deduction should be allowed. There can be no difference between this principle as applied to ore in the veins, and ore in the dump from those veins, which has not yet been converted into income. The operator is exhausting the owner's capital item, just as he exhausts the underground deposits in hoisting ore to the surface for immediate sale. No percentage deduction, in either case, is made available until the ore is sold and income derived. Until the values have been fully realized by converting ore into income, there is no reason why the dump ore should not still be considered to be ore from the mine for depletion purposes. Whether it is moved to a mill at once, or allowed to lie for a while on the dump, is clearly immaterial.

New Idria Quicksilver Mining Company v. Commissioner, supra,

Kennedy M. & M. Company v. *Commissioner, supra,*

Commissioner v. *Kennedy M. & M. Company, supra.*

To deprive a mine owner and his operating lessee of the percentage allowance, merely from the circumstance that the operating lessee was granted a lease only on dump ores at the mine, is to sacrifice substance to form and defeat the owner of compensation for the depletion to his wasting asset, as well as forfeiting the allowance provided for his operating lessee. Congress recognized in Sec. 23 (m) that owners would adopt various ways and means to recover and market their metallic values. It was enacted that they shall have "a reasonable allowance for depletion * * * *according to the peculiar conditions in each case,"* and further in the same section that "in case of leases the deductions shall be equitably apportioned between the lessor and lessee"; and later, in Sec. 114 (b) (4) (A), that "The allowance for depletion under Sec. 23 (m) shall be * * * in the case of metal mines * * 15 per centum * * * of the gross income *from the property* during the taxable year," etc.

In *New Idria Quicksilver Mining Co.* v. *Commissioner of Internal Revenue, supra,* the court, in approving the deduction for percentage depletion to the petitioner, said, at page 921:

> "The second question for determination is whether the New Idria Quicksilver Mining Company was entitled to claim percentage depletion on income derived from mining dumps on its land. The ore in the dumps had been milled years previously, but with the improved furnacing process, it was possible to salvage some of the ore. The dumps had always been a part of the land and no depletion had ever been claimed. This court in *Commissioner of Internal Revenue* v. *Kennedy Mining & Milling Co.*, 9 Cir., 125 F. (2d) 399, 400 said that 'tailings * * * were ores. They were ores from the taxpayer's mine, just as were the newly mined ores.' The Tax Court failed to distinguish the instant case and the Kennedy case. There is no legal distinction between the rights of the successor in interest and the rights of the original owner with respect to depletion claimed. See also *Consolidated*

Chollar, Gould & Savage Mining Co. v. *Commissioner of Internal Revenue,* 9 Cir., 133 F. (2d) 440."

In *Commissioner v. Kennedy M. & M. Co.,* 9 Cir., 125 Fed. (2d) 399, 400-401, the court said:

"The Commissioner contends that only so much of the taxpayer's income as was derived from newly mined ores was income from the mine; and that, since no net income was so derived, no deduction for depletion was allowable.

"The Commissioner's contention must be rejected. The tailings from which the taxpayer derived part of its gross income and all of its net income during 1935 and 1936 were ores. They were ores from the taxpayer's mine, just as were the newly mined ores which the taxpayer treated in 1935 and 1936. Income derived from the ores called tailings, as well as that derived from the newly mined ores, was income from the mine.

"It is true, but not material, that the ores called tailings were mined prior to 1935. The mining of ores and the receipt of income therefrom are seldom, if ever, simultaneous. The two events are usually months apart and not infrequently years apart. Thus income from a mine during a taxable year may, and usually does, include income from ores mined prior to that year.

"Nor is it material that these ores (now called tailings) were, prior to 1935, subjected to treatment whereby part of their gold content was removed. The ores so treated remained after such treatment, as they were before, the property of the taxpayer and were thereafter, as theretofore, ores from the taxpayer's mine. Income derived from their subsequent treatment was income from the mine just as was that derived from their first treatment.

"It is likewise immaterial that the subsequent treatment of these ores (in 1935 and 1936) was in a cyanide mill instead of a stamp mill. The right to deduct

for depletion of a mine a percentage of the gross or net income therefrom does not depend upon the type of mill used in treating the ores from which such income was derived. Nor is the taxpayer's right to the deductions here claimed affected by the fact that, prior to 1934, it claimed and was allowed deductions for 'unit' depletion in accordance with Revenue Acts then in effect. *Commissioner* v. *Elliott Petroleum Corp.*, 9. Cir., 82 F. (2d) 193.

"Atlas Mining Co. v. Jones, 10 Cir., 115 F. (2d) 61, cited by the Commissioner, is not in point. The taxpayer in that case was a contractor which had contracted with the owner of a tailings dump to treat the tailings therein for a share of the proceeds. *Neither party to the contract owned any mine.* The court held, and rightly so, that income resulting from performance of the contract was not income from a mine.

"Decision affirmed."

In *Kennedy M. & M. Co.* v. *Commissioner,* 43 B.T.A. 617, which was affirmed in the case just quoted, the Board of Tax Appeals said:

"And it is recognized by both parties that the mere extraction and actual depletion of mineral property does not either entitle the owner to depletion at that time nor prevent him from benefiting by it later when the ultimate step—recovery of income from the property—is taken. *Inspiration Consolidated Copper Co.,* 11 BTA1425; *National Petroleum & Refining Co.,* 28 BTA 569. It seems to us necessarily to follow that this would be so whether the process of extraction were completed but the product resulting remained undisposed of until later years; or, as occurred in petitioner's case, the process of extraction fell into two steps, was partially completed and brought about partial sales in one year, and the postponed and refined process of extraction made possible further sales in a subsequent year. * * *

"Nor is it of any greater consequence that some of the tailings may have been the residue of ores removed from the mine at a time when no percentage depletion was allowable to petitioner. For the time of receipt of the income determines not only the year for which percentage depletion is to be deducted, but the currently applicable law which is to be invoked. *Crews* v. *Commissioner* (C.C.A., 10th Cir.), 89 Fed. (2d) 412 (37-1 USTC 9196); *National Petroleum & Refining Co., Supra.* * * *

"For reasons which will now appear to be obvious, cases cited by respondent are inapplicable. In *Atlas Mining Co.* v. *Jones* (C.C.A., 10th Cir.), 115 Fed. (2d) 61 (40-2 USTC 9711), both the District Court, 29 Fed. Supp. 942 (39-2 USTC 9739), and the Circuit Court of Appeals emphasized that they did not purport to pass upon a situation where the tailings deposit remained the property, and the income therefrom remained the income, of the owner of the mine from which they had originally been extracted. Granting that a tailings deposit is not a mine as the court there held, it does not follow, of course, that its contents are not the product of the mining property, that minerals extracted therefrom did not have their origin in the mine, or, as respondent argues, that income from the sale of such minerals when ultimately recovered is not income from the mining property. See also *Carl M. Britt,* 43 BTA 254 (Jan. 7, 1941)."

Far from militating against the taxpayer at bar, as considered in the opinions below, the Ninth Circuit case of *Consolidated Chollar, Gould & Savage Mining Co.,* 133 F. (2d) 440, sustains our contention, because the facts were the converse of the situation at bar and in the *New Idria* and *Kennedy* cases. In *Consolidated Chollar,* the deduction for percentage depletion was denied because *the rock and ore dumps were created "from mines not located on such lands,* many years prior to the acquisition of such lands by the petitioner."

The court, at page 441 said:

"Petitioner contends that the deduction is warranted by our decision in Commissioner v. Kennedy Mining and Milling Co., 9 Cir., 125 Fed. (2d) 399. We do not agree. There we held the depletion deduction allowable because the recovery of mineral was from tailings of partially worked ore from a mine and mill owned by a taxpayer, deposited on taxpayer's land adjacent to the mine and mill from which they came, and hence the recovery was a mere continuation and completion of the processing of mineral extraction begun in the removal of the deposited material from the mine to the tailing dump."

The adverse opinions below also quote from *South Utah Mines & Smelters* v. *Beaver County*, 262 U.S. 325, 332, 43 S. Ct. 577, 579, 67 L. Ed. 1004, 1008, as follows (R.19):

"The tailings severed and removed from the mining claims, changed in character, placed on other and separate lands and having an ascertained and adjudicated value of their own, in our opinion, constituted a unit of property entirely apart from the mine from which they have been taken. See *Forbes* v. *Gracey*, 94 U. S. 762, 765."

This language is taken out of context in a case wholly unlike the facts and controversy at bar. The case concerned county taxes upon mining property, and the question of depletion was not involved. The Utah constitution provided that all property should be taxed in proportion to its value, and an amendment provided that mines should, in addition to an arbitrary valuation of $5 per acre, be assessed "at a value based on some multiple or submultiple of the net annual proceeds thereof." The legislature enacted a statute in pursuance of this amendment providing for assessment, in addition to the $5 per acre, upon a value to be determined by taking the multiple of three times the net annual proceeds thereof. The plaintiff mining corporation owned wholly depleted mining claims and also a concentrating mill which was obsolete and largely dismantled.

The mine itself was worked-out and worthless. Near the mill and about three miles away from the mine, the plaintiff had an accumulation of tailings, and made an agreement with the Utah Leasing Company for the treatment and reduction of this deposit upon a ten per cent royalty. In 1918 the leasing company recovered the net sum of $120,547.00 from the tailings, paying 10% to the plaintiff. The county taxing officials then multiplied this net sum recovered by three, and assessed the value of the plaintiff's *mine* for 1919 at $361,641.00, an obviously unfair conclusion.

From the opinion:

> "As a result of the concentrating operations refuse material, still retaining small quantities of copper and other metals, was deposited near the concentrating mill as tailings. This deposit was begun by plaintiff's predecessor as early as May, 1903, and from then until August, 1914, approximately 900,000 tons of tailings were accumulated upon desert land owned by plaintiff, nonmineral in character, and located about 3 miles from its mining claims."

The injustice of the assessment so made by the county caused this Court to say, on page 331:

> "The net proceeds here involved arose from a lot of refuse material, which, long prior to the imposition of the tax, had been severed from the mining claims, removed to a distance, submitted to the process of reduction, and stored upon lands separate and apart from the claims. Moreover, but one tenth of the amount of these net proceeds was realized by the owner of the mining claims. To treble the total of these proceeds for the purpose of basing thereon an altogether fictitious value for a mine worked out and worthless years before the adoption of the statutory provisions supposed to confer the authority to do so results in such flagrant and palpable injustice as would cast the most serious doubt upon the constitutionality of such provisions if thus construed. * * *

But the difference between a mine from which ore is being or still may be extracted and net income derived, and one conceded to be an empty shell, with no present or prospective value whatsoever, is so obvious that the imposition of a tax upon the basis of their being, nevertheless, one and the same, cannot be sustained with due regard to either law or logic."

This Court then carefully pointed out that it was not deciding or considering the measure of value of a mine which included dumps and tailings placed and remaining upon the mining claims or connected with a going mine, and said:

"How far the state statute defining the net annual proceeds to be considered in measuring the value of a mine properly includes those derived from dumps and tailings placed and remaining upon the mining claims or connected with a going mine, we do not determine; but we do hold that the proceeds from the tailings in question, under the facts here disclosed, are not included within its terms. The court below should have so construed the statute and rendered judgment for the plaintiff."

The facts and the reasoning of this Court therefore emphasize the error of relying on them in the decision against the taxpayer at bar in the court below, because of the opposite situation here presented.

The principle here at stake was missed entirely by the lower court when it argued that the dump itself is not a "mine" or a "natural deposit", a contention never advanced by the petitioner. The simple point is that the dump ores came from the mine and depleted the mine, and were merely in delayed transit to mill and market. Ores after extraction usually pause somewhere, often for a long time, either in underground stopes, in a dump on the surface near the collar of a shaft or the mouth of a tunnel, or in ore-bins near the mine or at a railroad siding, or at a mill or smelter awaiting treatment. If they never move on to the final step of treatment and sale, there is no legal

depletion of the mine affording a percentage deduction, because the measurement of the depletion never takes place. But the period of delay before sale and consequent income is immaterial. It is not the dump that has been depleted, nor the underground stope-fill, nor the ore-bin; it is the mine and natural deposit underground that has experienced depletion, the legal measure of which is only determined when a money income is derived from sales. This principle is clearly understood and applied in the Ninth Circuit cases.

In the sense dissociated from the special percentage depletion provisions of the revenue law, Sec. 114 (b) (4), depletion of the vein does of course occur at the time the ores are extracted from it, but the taxpayer here had elected to take percentage depletion, hence the amount of such depletion could not be ascertained until the ores were sold and income derived.

III.

If this Court were to conclude that an ordinary unrelated lessee of a mine-owner cannot have the percentage deduction where its lease included only the dump, still the deduction should nevertheless be allowed here "according to the peculiar conditions", under Sec. 23 (m), because of the essential unity of the mine-owner London Extension and its nominal lessee.

The facts stipulated (R. 48) are that "Chicago Mines Company, a wholly owned subsidiary corporation of the petitioner, entered into a lease from petitioner on June 10, 1940, under which Chicago Mines Company proceeded to mill that part of the American dump which could be sorted and milled at a profit until October 8, 1940, when Chicago Mines Company was dissolved"; and that (R. 8) "The corporate life of Chicago Co. expired October 8, 1942, and all its assets previously were transferred to its parent company London Co. (London Extension) and the capital stock held by said parent company and the qualifying shares held by its directors were at that time cancelled and surrendered." And at R. 7: "Chicago Co. was

a wholly owned subsidiary of The London Extension Mining Company, petitioner * * *". The paper styled a Lease Contract (R. 4-5), wherein the parent company and mine-owner held all of the stock, and the qualifying shares were held by its directors, was signed by the same persons respectively vice-president and secretary of the nominal lessor, and president and secretary of the nominal lessee. It is obvious that Chicago Mines was a mere department for the mine-owner, and that the nominal lessor was and is the real and only party in interest in the transaction involving metals from its mine.

This court has held that under such circumstances the corporate entities are to be disregarded where a legislative policy to encourage a particular activity is advanced. Mr. Justice Reed, speaking for this court in *Moline Properties Inc.* v *Commissioner of Internal Revenue,* 319 U.S. 436, 63 S. Ct. 1132, 87 L. Ed. 499, at 1503, said:

> "A particular legislative purpose, such as the development of the merchant marine, whatever the corporate device for ownership, may call for the disregarding of the separate entity. *Munson S. S. Line* v. *Commissioner of Internal Revenue* (CCA 2d), 77 F. (2d) 849."

Here the "particular legislative purpose" is that the owner of the depleted mine can take his capital depletion in a policy of encouraging production of mineral supplies. The short supply of metals presents a national need comparable to the need for merchant ships.

In the decision above cited and followed by this Court, *Munson S. S. Line* v. *Commissioner of Internal Revenue,* (CCA 2d), 77 Fed. (2d) 849, the court discusses this principle at length, at pages 850-1, from which we quote:

> "The declared purpose of the Merchant Marine Act of 1920 was to encourage the development and maintenance of an American merchant marine. 46 USCA Sec. 861. Pursuant to that purpose section 23 (46 USCA, Sec. 878) offered to the 'owner' of a vessel

documented in the United States and operated in foreign trade, as an inducement to invest the earnings in additional ships, the allowance of a deduction for the computation of war-profits and excess-profits taxes. The present dispute concerns the meaning of the word 'owner' as used in this section. Construed narrowly, as the Commissioner contends it should be, only the subsidiary corporations may be deemed the owners of the vessels respectively documented in their names. Construed broadly, the petitioner may be deemed the owner of the subsidiaries' vessels because of its stock ownership of the subsidiaries and its exercise of dominion over them and their property. That the word 'owner' may be given a broad interpretation in order to carry out the legislative purpose is well illustrated by *Flink* v. *Paladini,* 279 U.S. 59, 49 S. Ct. 255, 73 L. Ed. 613, where stockholders of a corporation which owned a vessel were held to be within the act limiting the liability of shipowners (46 USCA Sec. 183) in order to save them from the rigors of a California statute which made stockholders liable for corporate obligations. The opinion by Mr. Justice Holmes states the rationale of the decision as follows:

> " 'The purpose of the act of Congress was "to encourage investment by exempting the investor from loss in excess of the fund he is willing to risk in the enterprise." * * * For this purpose no rational distinction can be taken between several persons owning shares in a vessel directly and making the same division by putting the title in a corporation and distributing the corporate stock. The policy of the statutes must extend equally to both. In common speech the stockholders would be called owners, recognizing that their pecuniary interest did not differ substantially from those who held shares in the ship. We are of opinion that the words of the acts must be taken in a broad and popular sense in order not to defeat the manifest intent.'

"Similarly, in *Olds & Whipple, Inc.* v. *Com'r.*, 75 F. (2d) 272, this court interpreted broadly the phrase 'owned by the same interests' and held that a corporation and its stockholders were the same interests for purposes of the statute relating to affiliation.

"The petitioner's argument that the broad construction for which it contends is more consonant with the purpose of promoting investment in new American ships seems to us well taken. No reason is apparent, or has been suggested, why Congress should wish to limit its encouragement to corporate shipowners whose vessels were held directly and to exclude a corporation which operated through wholly-owned subsidiaries. Indeed, to treat the parent corporation as owner of the vessels operated through subsidiaries would serve the purpose of the statute better than would a literal interpretation which confines 'owner' to the holder of legal title. A corporation operating a single vessel is likely to have to accumulate its earnings over a considerable period before they will suffice to build an additional vessel. The necessary surplus for such investment will be more quickly obtained by a company operating several vessels. This will be equally true whether the operating company has legal title to the vessels or is a holding company operating them through wholly-owned subsidiaries. Hence it would tend to produce a greater investment of earnings in new ships to offer to such parent corporation the encouragement of the deduction allowed by section 23 to vessel owners. An interpretation reaching this result should be adopted if the words used will permit of it. We think they will.

"* * * * * * Thus even in tax cases the separate identity of corporations may be disregarded in exceptional circumstances. See, also, *Gulf Oil Corp.* v. *Lewellyn*, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133; *New Colonial Ice Co. v. Helvering*, 292 U. S. 435, 442, 54 S. Ct. 788, 78 L. Ed. 1348. In our opinion to disregard it under the circumstances here disclosed will

better carry out the legislative purpose of the statute in question. Accordingly we hold that the petitioner should be deemed the owner of the subsidiaries' vessels within the meaning of section 23."

As said by Circuit Judge Bratton in *Inland Co.* v. *Commissioner,* 120 Fed. (2d) 986, on page 988:

"But it is equally well settled that extraordinary circumstances sometimes exact the disregard of such separateness of entity in the solution of problems relating to taxes. *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 37 S. Ct. 540, 62 L. Ed. 1142; *Gulf Oil Corporation* v. *Lewellyn,* 248 U.S. 71, 39 S. Ct. 35, 63 L. Ed. 133; *Burnett* v. *Commonwealth Improvement Co.* supra; *Gregory* v. *Helvering,* 293 U. S. 465, 55 S. Ct. 266, 79 L. Ed. 596, 97 A.L.R. 1355; *Griffiths* v. *Commissioner,* 308 U.S. 355, 60 S. Ct. 277, 84 L. Ed. 319; *Higgins* v. *Smith,* 308 U.S. 473, 60 S. Ct. 355, 84 L. Ed. 406; *Continental Oil Co.* v. *Jones,* supra. * * * That separateness is disregarded where the ownership of stock is used to dominate and control the subsidiary in such manner and to such extent that it becomes a mere agency or instrumentality of the parent. *United States* v. *Lehigh Valley R. R. Co.* 220 U. S. 257, 31 S. Ct. 387, 55 L. Ed. 458; *U.S.* v. *Delaware, Lackawanna & Western R. R. Co.,* 238 U.S. 516, 35 S. Ct. 873, 59 L. Ed. 1438; *Chicago M. & St. Paul Ry. Co.* v. *Minneapolis Civic Assn.,* 247 U. S. 490, 38 S. Ct. 553, 62 L. Ed. 1229; *United States* v. *Reading Co.,* 253 U. S. 26, 40 S. Ct. 425, 64 L. Ed. 760; * * *

"* * * But whatsoever the underlying reason may have been, it is clear that the subsidiaries were nothing more than voiceless departments or instrumentalities of the taxpayer. Substance is paramount over form in the application of income tax laws. *United States* v. *Phellis,* 257 U.S. 156, 42 S. Ct. 63, 66 L. Ed. 180; *Tulsa Tribune Co.* v. *Commissioner of Internal Revenue,* 10 Circ., 58 F. (2d) 937; *Reynolds* v. *Cooper,* 10 Cir., 64 F. (2d) 644, affirmed, 291 U. S. 192, 54 S. Ct. 336, 78 L. Ed. 725; *North Jersey Title Insurance*

Co. v. *Commissioner of Internal Revenue,* 3 Cir., 84 F. (2) 898; *Commissioner of Internal Revenue* v. *Texas Pipe Line Co.,* 3 Cir. 87 F. (2d) 662. * * *"

At bar it seems a "distinction without a difference" whether Mr. Bishop was president of both companies, instead of president of one and secretary of the other, and Dr. Fraser secretary of both, or whether they used the same or a different stenographer and bookkeeper, or foreman and superintendent, so long as London Extension owned Chicago Mines and all its assets, "lock, stock and barrel," until its dissolution (Stip., pars. 1 and 6, R. 7 and 8; Ex. B, R. 5), all ownership being exclusive in London Extension and each dollar being by way of gain or expense to London Extension, owner and transferee. "He who does anything through another is doing it himself." Whether they may or may not have used a different agent in any connection appears trivial and irrelevant, since agency does not affect the status of the principal or the substance involved in unity of ownership, London Extension owning and holding 100% of Chicago Mines stock. The equities in the taxpayers' situation at bar should bring it within the exceptions, for Sec. 23 (m) itself says that deductions "shall be allowed * * * according to the peculiar conditions in each case." The Congressional purpose is to encourage output of metal.

IV.

We also ask a review and reversal of new judicial restrictions limiting a right to depletion deductions, announced in the opinion below. These violate principles of depletion intended by Sections 23 (m) and 114, and previously announced by the Ninth Circuit and by the Board of Tax Appeals in the *New Idria* and *Kennedy* opinions. The proposed new barriers would deny the deduction unless the taxpayer marketing ores from his mine dump could show an accompanying intent to work the dump at a future time, at the time the dump ores were deposited on the property (R. 64, 66), and would further prescribe that the working of the dump must be "an integrated step in the original mining operation" (R. 66, 65), or "an

integrated part of the original mining operation" (R. 64). Such restrictions would disregard the fact and theory of depletion. They would also impose oppressive difficulties of proof, and create needless disputes and injustices, often eliminating any real chance of a just allowance for depleted capital assets.

It is characteristic of mine dumps, especially rather old ones, that they are the composite product of a series of operations by various prior owners, lessees and optionees, by whose efforts they were built up in successive layers over the years. In a correct view of depletion, details of prior ownership and leases are utterly immaterial. They do not affect the merits at bar, or in any case of the typical dump at a mine. This is true because of the great essential of depletion in the mine and the legislative policy recognizing the underlying fact of depleted capital. The mine has been neither more nor less depleted by the extraction of ore, from the fact that several various lessees operating under the owner, and various owners operating themselves, may have done the work and built up the dump, with no doubt a wide variety of hopes, plans and opinions about the future. The proposed new restrictions would unfairly defeat the allowance in most cases, for the reason that if the dump is created by a lessee and he does nothing with it, the owner will not be able to establish an "accompanying intent", since the lessee when he gave up the lease, leaving the dump, had no intention of later recovering the values, however rich the later improved processes, or increased prices, or better operating labor or facilities, may cause them to become. If part of the dump were created by a former owner, part by former lessees, part by the present owner, and part by his later lessees (which would be a typical case), with the former owners and lessees dead or gone, it would not be possible for the mine owner to establish an accompanying intent as to layers of the dump (which practically never is worked in layers, but in perpendicular blocks), and he would be denied depletion of the mine and natural deposits, notwithstanding the fact that the statutory percentage becomes determinable from income as he sells the dump ores.

The further proposed bar to the allowance, requiring a mine owner to show that his dump ore was worked and marketed "as an integrated part of the original mining operation" (R. 64, 66), is also untenable. It is not sustained by the statute, is against the decisions cited herein, and does not accord with the necessities of mining. The phrase is likewise vague in its meaning and implications. We submit that the only material integration is that which exists from the origin of the dump ore in the underground veins, to measure the depletion thereof when sold; and there is thus an integrated chain or flow from the owner's natural deposit into his pocket or bank account, from which the statutory depletion of the deposit is computed.

To avoid repetition we respectfully refer the Court to the more detailed discussion, giving practical examples on this subject, in the memorandum by *amici curiae* representing The Colorado Mining Association (R. 83-97) in support of the petition for rehearing.

Also, to avoid repeating a lengthy review of the *Kirby, Douglas* and *Herring* decisions of this Court, we refer to the other brief by friends of the court filed below (R. 101-124).

CONCLUSION.

We therefore ask that the decisions below be reviewed and reversed.

Respectfully submitted,

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APPENDIX

STATUTORY PROVISIONS

The statutory provisions involved are found in paragraph (m) of Sec. 23, and paragraph (b), sub-paragraphs (4) (A) and (B) of Sec. 114 of the Internal Revenue Code, Title 26 U.S.C.A. Sub-paragraph (4) (B) of paragraph (b) of Sec. 114 was added by Sec. 124 (c) of the Revenue Act of 1943, and is as effective as through it were in the revenue laws applicable to all taxable years beginning after December 31, 1931.

Section 23, in force for the taxable periods here involved, insofar as pertinent, is as follows:

"Section 23. Deductions from Gross Income. In computing net income there shall be allowed as deductions: * * *

"(m) Depletion. In the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowances in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *."

Section 114, in force for the taxable periods here involved, insofar as pertinent, is as follows:

"Section 114. Basis for Depreciation and Depletion. (b) Basis for Depletion.—(4) Percentage Depletion for * * * Metal Mines * * *.

"(A) In general. The allowance for depletion under Sec. 23 (m) shall be * * * in the case of metal mines, * * * 15 per centum * * * of the gross income from the property during the taxable year, excluding from

such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property * * *."

Section 114 (b) (4) (B). as added by Section 124 (c) of the Revenue Act of 1943, effective as though it had been in the revenue laws applicable to all taxable years beginning after December 31, 1931, so far as pertinent, is as follows:

"(4) (B). Definition of Gross Income from property. As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: * * *; and (iv) in case of lead, zinc, copper, gold, silver or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and benefication by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 731 and 735."

REGULATIONS 103.

Treasury Regulations 103, so far as appears applicable here, is as follows:

"Sec. 19.23 (m)—1 (as amended by T. D. 5210, Jan. 8, 1943). Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvement.—

"Sec. 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

"Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a constructual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest."

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OCTOBER TERM, 1947

No. 691

CHICAGO MINES COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 692

THE LONDON EXTENSION MINING COMPANY, AS TRANSFEREE OF CHICAGO MINES COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 693

THE LONDON EXTENSION MINING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 9–21) is reported at 7 T. C. 1103. The opinion of the Circuit Court of Appeals (R. 61–66) is reported at 164 F. 2d 785.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on November 6, 1947. (R. 67–68.) A petition for rehearing (R. 69–80) was filed on November 26, 1947, and was denied on January 8, 1948 (R. 125). The petitions for writs of certiorari were filed on March 25, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

A dump of discarded waste material and low-grade ore was created on the surface of the land by a former operator of a mine. One of the taxpayers, London Company, which also had an ownership interest in the mining property, acquired the working lease to the underground mine and, as an incident to the lease, the right to work the dump. During a portion of the taxable period, it granted to its wholly owned subsidiary, a lease entitling the subsidiary to sort and mill the contents of the dump. During the remaining portion of the taxable period, the London Company worked the dump itself.

1. Did the Circuit Court of Appeals err in holding that the dump was not a mine under Section 23 (m) of the Internal Revenue Code and that no deduction for depletion with respect to it could be taken by the London Company, since the dump was not created by it and was not operated as an integral part of its underground mining operations?

2. Did the Circuit Court of Appeals err in holding that the subsidiary, which did not even have a collateral interest in any mining property, was not entitled to a depletion deduction on its operations in sorting and milling the contents of the dump?

STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the statutes and regulations involved are set forth in the Appendix, *infra*, pp. 16–23.

STATEMENT

These cases were consolidated before the Tax Court. The facts were stipulated (R. 7–8, 36, 47–49) and the Tax Court made its findings in accordance with the stipulations (R. 10). The facts, which are pertinent to the three cases here involved, may be summarized as follows:

The taxpayer, Chicago Mines Company, referred to as Chicago Company, was a corporation organized in 1937 under the laws of the State of Colorado. The taxpayer, The London Extension Mining Company, referred to as London Com-

pany, is a corporation organized in 1925 under the laws of the State of Colorado. Chicago Company was a wholly-owned subsidiary of the London Company (R. 10.)

The London Company owns an undivided one-half interest in the American, Fraction, Huron and Ibex lode mining claims in Park County, Colorado. The remaining one-half interest in the American claim is owned by a group of individuals sometimes called the Ellis heirs. The remaining undivided one-half interests in the Fraction, Huron and Ibex claims are owned by The London Mines and Milling Company, a corporation having no relationship with London Company. London Company acquired its undivided one-half interest in the American claim on October 11, 1929, and its undivided one-half interests in the Huron, Fraction and Ibex claims in 1926 and 1927. These claims collectively are known as the American Mine . (R. 10–11.)

Amer Mining Company, a Colorado corporation, obtained a lease from the Ellis heirs, the taxpayer London Company, and The London Mines and Milling Company to prospect and mine certain blocks of the American, Fraction and Ibex claims and to extract ore therefrom. This lease was successively assigned to W. A. Ellis, Inc., and thence to the taxpayer London Company on or about June 7, 1940. During the period 1930 to May, 1940, the Amer Mining Com-

pany in connection with its operation of the American Mine under the lease shipped the high-grade ore and placed the resulting waste material and low-grade ore upon the surface of the ground, thus creating the American dump. The greater portion of this dump was placed upon the surface of the Fraction claim, smaller portions being on the surface of the American and Huron claims, all these claims being contiguous. (R. 11.)

Taxpayer, Chicago Company, entered into a lease with London Company on June 10, 1940, under which Chicago Company immediately thereafter proceeded to mill that part of the American dump which could be sorted and milled at a profit, until October 8, 1940, when Chicago Company was dissolved. The lease provided, *inter alia,* that the London Company, owner of the American Waste Dump, leased it to Chicago Company, in consideration of royalties of twenty per cent of net smelter and mint returns; and that Chicago Company could use the buildings and equipment on the claim to house and board men, and could remove, during or at the end of the lease, any equipment and supplies belonging to it. The party signing as president of the Chicago Company also signed as secretary of the London Company, and the vice president of London Company signed as secretary of Chicago Mines. No other officers signed the lease. From October 8, 1940, to the end of that year, London

Company itself carried on the working and milling of the American dump. From June 7, 1940, London Company also carried on underground mining operations under its leases until August 20, 1940, when its lease from the Ellis heirs expired, and for the remainder of 1940 continued to operate under the Colorado co-owner statute (3 Colorado Statutes Annotated, c. 92, Secs. 8 to 16). (R. 11–12.)

Chicago Company, in its income tax return filed for the year June 1, 1940, to May 31, 1941, deducted percentage depletion of $10,150.34, which sum represents fifteen per cent of its gross income, after deduction of royalties, from its operation and milling of the American dump. This amount did not exceed fifty per centum of the net income of Chicago Company from the American dump. (R. 12.) Its tax liability is involved in the petition filed in No. 691.

The corporate life of Chicago Company expired October 8, 1942, and all its assets previously were transferred to its parent company, London Company, and the capital stock held by the parent company and the qualifying shares held by its directors were at that time canceled and surrendered. (R. 12.)

The London Company is liable as a transferee for any deficiency in income tax for the taxable year June 1, 1940, to May 31, 1941, and any deficiency in excess profits tax for the taxable

period June 1, 1940, to October 8, 1940, that may be determined against Chicago Company, together with interest as provided by law. (R. 12.) Its tax liability, as transferee, is involved in the petition filed in No. 692.

As a result of London Company's working of the American dump during 1940, it realized $57,014.58 as its net smelter returns after deducting marketing and transportation costs. It also received $16,917.23 as royalties under its lease to Chicago Company on the dump. It also received $22,638.45 as its net smelter returns on its underground mining operations of the American Mine. London Company claimed depletion in its return; and it is agreed that if it be decided that London Company is entitled to depletion on the operation of the American dump and that the operations of the dump and the American Mine constitute one mining property, then London Company would be entitled to $14,485.54 disallowed depletion (i. e., American Mine $3,395.77, American dump $8,552.19, American dump royalties $2,537.58). (R. 12–13.) Its own tax liability is involved in the petition filed in No. 693.

The only questions that were required to be passed on by the Tax Court related to the deductions for depletion which had been claimed by the taxpayers, other matters having been abandoned. The Tax Court upheld the Com-

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missioner's deficiency determinations. The Circuit Court of Appeals (R. 61–66) affirmed the decisions of the Tax Court.

ARGUMENT

1. The decisions below are correct in denying any deduction for depletion to the taxpayers who derived income from operating a dump composed of discarded waste materials and low-grade ore deposited on the surface of the ground by a former mine operator. The statutory deduction for depletion in Section 23 (m) of the Internal Revenue Code, Appendix, *infra*, is granted only "In the case of mines * * * and * * * other natural deposits * * *." An artificially created pile of materials, even though it contains some mineral elements, is not a mine within the intendment of the statute, and a taxpayer who earns income by processing discarded materials previously removed from a mine by another, and who had no connection with severing these materials from the natural deposit in which they previously had been incorporated, is not engaged in a mining operation. The deduction for the depletion of a capital investment in a natural resource was never intended to be granted to a taxpayer who is merely processing the output of a mine. *Consolidated Chol. G. & S. M. Co.* v. *Commissioner,* 133 F. 2d 440 (C. C. A. 9th); *Atlas Milling Co.* v. *Jones,* 115 F. 2d 61 (C. C. A. 10th), rehearing denied, 115

F. 2d 64, certiorari denied, 312 U. S. 686; *Britt* v. *Commissioner,* 43 B. T. A. 254; cf. *Helvering* v. *Bankline Oil Co.,* 303 U. S. 362.

In the present case, Chicago Company was a lessee having rights only in relation to milling and sorting the dump, and in recovering further mineral wealth from previously mined ores. It stands in a position comparable with that of the taxpayer in *Helvering* v. *Bankline Oil Co., supra,* which was engaged in processing casinghead gasoline at the mouths of wells where natural gas was produced. It was held that the taxpayer there had no interest in the wells, that it was not engaged in producing the mineral product for which the deduction for depletion is granted, and that, as a processor of a mineral product, it was not entitled to any part of the allowance granted for depletion. The petitioners in the present case stand in a weaker position than the taxpayer in the *Bankline* case, for there the process of extracting the gasoline and of transforming the wet gas into saleable dry gas, was directly associated with the production by the well operators of the wet gas from the wells. The taxpayers here, in sorting and milling the contents of the dump, were not even engaged in any processing directly connected with the mining production carried out in prior years by the then mine operator. The taxpayers are not entitled to a deduction for percentage depletion with respect to the income which

they derived from operating the dump for the plain reason that they are not thereby engaged in operating a mine or deriving income from any mining operations.

2. There are no conflicting decisions respecting the issue raised by the petition in No. 691, involving Chicago Company, or in No. 692, representing the transferee liability of London Company for the same tax deficiency involved in No. 691. The Circuit Courts of Appeals for the Ninth and Tenth Circuits are fully agreed that a taxpayer who has no interest of any character in an underground mine is not entitled to a deduction for depletion when it possesses rights only with respect to the recovery of minerals from an artificially created deposit containing ores which had been mined previously. *Consolidated Chol. G. & S. M. Co.* v. *Commissioner, supra; Atlas Milling Co.* v. *Jones, supra.*

On the assumption that the taxpayer, London Company, would be entitled to depletion on its income from the dump, an assumption with which we cannot agree, it is asserted that Chicago Mines becomes entitled to the deduction because it was a subsidiary of the London Company which owned all of its capital stock. (Pet. 8–9, Br. 28–33.) This contention is opposed by the uniform decisions of this Court to the effect that a corporation which is engaged in conducting a business is a distinct taxpayer from its stockholders, even

where all the stock is owned by one shareholder, and that no merging of their affairs can affect any tax consequences where sham or fraudulent transactions are absent. *Moline Properties* v. *Commissioner,* 319 U. S. 436; *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590; *United States* v. *Joliet & Chicago R. Co.,* 315 U. S. 44; *Higgins* v. *Smith,* 308 U. S. 473; *New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415; *Edwards* v. *Chile Copper Co.,* 270 U. S. 452. Nor is there any exception to these principles where the subsidiary is supposed to be (Br. 29) "a mere department" of the parent. If there were such an exception, the Tax Court's findings (R. 15–16) that there was no essential identity between the two corporations would, nevertheless, be conclusive. The relationship of a subsidiary corporation to its parent, moreover, is not one of the "peculiar conditions" under which Section 23 (m) provides that the deduction is to be granted, nor has it ever been recognized in the Commissioner's regulations, promulgated under the express terms of Section 23 (m). (cf. Br. 21, 28–33.)

3. The taxpayer, London Company, either with respect to the royalties which it received from Chicago Company's operation of the dump, or with respect to the income which it later derived from its own operations, was also not engaged in operating a mine and was not entitled to any

deduction for depletion. While it, unlike Chicago Mines, had an interest in the underground mine (its interest arising from a partial ownership of the mining claims and also from the acquisition of the operating lease to the underground mine), the dump was created by a previous operator who discarded the waste materials and low-grade ore, and the dump was worked by Chicago Company and later by London Company separate and apart from the underground mining which London Company was conducting. These two distinct functions being carried on by the London Company cannot be merged, and the character of the income received by it from the contents of the dump cannot be altered by the fact that it was separately engaged in operating a mine, and by the coincidental factor that the dump was created by a former operator of the same underground mine. Where the two are not an integral part of the mining operation which he performs, the income from a distinct processing function is not depletable and does not become so because the processor also happens to be the operator of a mine. He is entitled to percentage depletion only on the gross income derived from the mining operations conducted with respect to the natural mineral deposits. Section 114 (b) (1), (4), Internal Revenue Code, Appendix, *infra;* Treasury Regulations 103, Sec. 19.23 (m)–1 (b), Appendix, *infra;* cf. *Helvering* v. *Mountain Producers Corp.,* 303 U. S. 376, 382. The deduc-

tion is granted to a taxpayer only to the extent that he derives income from the process of extracting mineral wealth from their natural deposits and whose capital investment is depleted as the natural deposit is depleted. *Kirby Petroleum Co.* v. *Commissioner,* 326 U. S. 599, 603–604; *Burton-Sutton Oil Co.* v. *Commissioner,* 328 U. S. 25, 34–35.

While the decision below is asserted to be in conflict with decisions of this Court (Pet. 10), we believe that the cases relied on are so clearly without any significant bearing on the issue here as to warrant no discussion of them.

The court below did not recognize that a conflict exists between the decision in this case and the rulings of the Circuit Court of Appeals for the Ninth Circuit. It noted that *Consolidated Chol. G. & S. M. Co.* v. *Commissioner, supra,* was decided by the Ninth Circuit in harmony with the rule of the Tenth Circuit which had previously been applied in *Atlas Milling Co.* v. *Jones, supra,* and which was again followed in the present case. The court below also referred to *Commissioner* v. *Kennedy Min. & M. Co.,* 125 F. 2d 399 (C. C. A. 9th), and *New Idria Quicksilver Min. Co.* v. *Commissioner,* 144 F. 2d 918 (C. C. A. 9th), on which the taxpayers rely for the asserted conflict in decisions, and stated (R. 65):

> Our analysis of these decisions by the Ninth Circuit leads us to conclude that it adheres to the principle that a taxpayer,

> working a dump, may take depletion allowances only in those cases in which the operation is an integrated step in a mining operation, and which is the final step in the process which had its beginning when the ore was removed from the original vein.

In the *Kennedy* case, the taxpayer was the owner and operator of a mine and had itself created a tailings dump which it reworked during the taxable years by means of an improved process which it also employed in connection with its newly mined ores. In the *New Idria* case the taxpayer again was the owner and operator of a mine. As a result of previous operations by former operators, there were deposits of discarded ore on the surface of the land from which the taxpayer was able to recover additional amounts of mercury by means of an improved process which it also employed in connection with the newly mined cinnabar ore from its mines. In both cases the court held that taxpayers were entitled to the allowance for depletion with respect to the retreated ores as well as those newly mined.

Although we think that the *Kennedy* and *New Idria* cases were decided incorrectly, there are differences between them and the present case, and the court below thought that its decision was distinguishable. Moreover, the decision be-

low is fully in harmony with the decisions of this Court.

CONCLUSION

The decision below is correct. There are no conflicting decisions or other factors which would warrant further review by this Court of the judgments for which the petitions were filed in Nos. 691 and 692, and those petitions should be denied. The judgment in No. 693 may be out of harmony with the principles applied by the Circuit Court of Appeals for the Ninth Circuit, but the cases were regarded as distinguishable by the court below, and the decision below is completely in accord with the decisions of this Court. The petition in No. 693 should also be denied.

Respectfully submitted.

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APRIL 1948.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(4) [as amended by Section 145 of the Revenue Act of 1942, c. 619, 56 stat. 798, and Section 124 of the Revenue Act of 1943, c. 63,

58 Stat. 21] *Percentage depletion for coal, fluorspar, flake, graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite spodumene, barite, ball and sagger clay, rock asphalt, and metal mines, potash, and sulphur.—*

(A) *In general.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mine, fluorspar, flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, barite, ball and sagger clay, or rock asphalt mines, and potash mines or deposits, 15 per centum, and in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

(B) *Definition of Gross Income From Property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—clean-

ing, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of section 731 and 735.

* * * * *

(26 U. S. C. 1940 ed., Supp. V, Sec. 114.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (m)–1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—Section 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells,

other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

* * * * *

(b) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.

* * * * *

(f) [as amended by T. D. 5210, 1943 Cum. Bull. 140, T. D. 5413, 1944 Cum.

Bull. 124, and T. D. 5461, 1945 Cum. Bull. 284] The term "gross income from the property," as used in sections 114 (b) (3) and 114 (b) (4) (a) and sections 19.23 (m)-1 to 19.23 (m)-28 [articles 23 (m)-1 to 23 (m)-28 of Regulations 101, 94, and 86, and articles 221 to 248 of Regulations 77], inclusive, means the following:

In the case of oil and gas wells, "gross income from the property" as used in section 114 (b) (3) means the amount for which the taxpayer sells the oil and gas in the immediate vicinity of the well. If the oil and gas are not sold on the property but are manufactured or converted into a refined product prior to sale, or are transported from the property prior to sale, the gross income from the property shall be assumed to be equivalent to the representative market or field price (as of the date of sale) of the oil and gas before conversion or transportation.

In the case of a crude mineral product other than oil and gas, "gross income from the property," as used in section 114 (b) (4) (a) means the gross income from mining. The term "mining" as used herein includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products.

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by

the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product. If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes beyond the ordinary treatment processes.

If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

The term "ordinary treatment processes," as used herein, shall include the following:

(1) In the case of coal—cleaning, breaking, sizing, and loading for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment;

(3) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment;

(4) In the case of lead, zinc, copper, gold,

silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization precipitation, or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore. The furnacing of quicksilver ores is included in the term "ordinary treatment processes." The following processes are not included in the term "ordinary treatment processes": electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

In case any of the ordinary treatment processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by the taxpayer, the proportionate profits attributable to transportation, should be subtracted from the sale price of the product to determine "gross income from the property." If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

In all cases there shall be excluded in determining the "gross income from the property" an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect of the property and are not otherwise excluded from the "gross

income from the property." If royalties in the form of bonus payments have been paid in respect of the property in the taxable year or any prior years or if advanced royalties have been paid in respect of the property in any taxable year ending prior to December 31, 1939, the amount excluded from "gross income from the property" for the current taxable year on account of such payments shall be an amount equal to that part of such payments which is allocable to the product sold during the taxable year. If advanced royalties have been paid in respect of the property in any taxable year ending on or after December 31, 1939, the amount excluded from "gross income from the property" for the current taxable year on account of such payments shall be an amount equal to the deduction for such taxable year taken on account of such payments pursuant to section 19.23 (m)-10 (e).

* * * * *

(h) "Crude mineral product," as used in paragraph (f) of this section, means the product in the form in which it emerges from the mine or well.

(i) "The property," as used in section 114 (b) (2), (3), and (4) and sections 19.23 (m)-1 to 19.23 (m)-19, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer's interest in each separate mineral property is a separate "property"; but, where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property," provided such treatment is consistently followed.

U. S. GOVERNMENT PRINTING OFFICE: 1943

ERRATA

Nos. 691-693

Page 11.—Sixth line from bottom of page. The word "unexcelled" should read "unexplored."

Page 14.—In lines 12, 15 and 19 — The word "gold" should read "metal."

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SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1947

Nos. 691-693

CHICAGO MINES COMPANY, Petitioner,

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THE LONDON EXTENSION MINING COMPANY,
as Transferee of CHICAGO MINES COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

THE LONDON EXTENSION MINING COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF OF JOHN HAMM, AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

In support of Petitioner's petition for Writ of Certiorari, John Hamm, an individual residing at Leadville, Colorado, as Amicus Curiae, respectfully submits the within Brief in support of Petition for Certiorari.

OPINION OF COURT BELOW

The opinion of the Circuit Court of Appeals, Tenth Circuit, dated November 6, 1947, is reported in 164 Fed. (2d) 785, Advance Sheets of February 9, 1948, and is found in the record commencing at page 61.

GROUNDS ON WHICH JURISDICTION OF SUPREME COURT OF UNITED STATES IS INVOKED

The grounds upon which jurisdiction of the Supreme Court is invoked are set forth in Petitioner's Brief, page 14.

STATEMENT OF CASE

A brief statement of the case is set forth in Petitioners' Brief, pages 14-16, and for brevity will not be repeated here.

John Hamm respectfully represents to the Court that he is now and has been for several years engaged in mining operations, principally as lessee of ore dumps and that he is directly concerned and affected by the decision of the Court below in this case and especially the decision as to No. 3508, wherein Chicago Mines Company is Petitioner.

SPECIFICATION OF ERRORS

Petitioner's specification of errors is set forth in Petitioners' Brief, page 16, and will not be repeated here. Discussion herein, however, will be confined to those of Petitioners' specifications which involve the failure of the court below to follow and apply this Court's decisions in *Herring v. Commissioner,* 292 U.S. 322, 55 S. Ct. 179, 79 L. Ed. 389; *Douglas v. Commissioner,* 322 U. S. 275, 64 S. Ct. 988, 88 L. Ed. 1271; and *Kirby Petroleum Company v. Commissioner,* 326 U. S. 599, 66 S. Ct. 409, 90 L. Ed. 343.

Rephrasing petitioner's specifications of errors, numbers 1 and 2, it is submitted that the United States Supreme Court of Appeals, Tenth Circuit, erred:

1. In denying to the owner and to the lessee deductions for depletion under Sec. 23 (m) and Sec. 114(b)(4)(A) and (B), upon the ground that income realized from dump ore as distinguished from newly mined ore is not income from a mine.

2. In failing to apply the principle that an owner and his lessee of a mining property have an economic interest therein and thus are entitled to a deduction for depletion under Sec. 23(m), computed as a percentage of income from the property under Sec. 114(b)(4)(A) and (B).

ARGUMENT

I.

Percentage depletion deductions apply to income from a mining property, irrespective of whether such income results from current, past, or anticipated future production of ores from the natural deposit.

The court below denied to the owner of the mineral property, and to the lessee of the owner, a deduction for percentage depletion calculated upon income derived from ores which had been produced in earlier years from the owner's mine and stored in a dump on the surface of the property. The lower court stated the issue to be whether a "dump" is a "mine" within the meaning of Sec. 23(m). It held that a "dump" was not a "mine" within that Section and therefore that income from the ore in the dump was not "income from the property", within the meaning of Sec. 114 (b)(4)(A) and (B), upon which percentage depletion is allowed. The court interpreted the words "in the case of mines", appearing in both Sec. 23(m) and 114(b)(4) as being limited to "an exacavation in the earth from which minerals are removed by digging or

other mining processes" . . . "the vein load or deposit of minerals"; and the court therefore held that "mining thus connotes the removal of minerals from a natural deposit and does not include the re-working of mineral dumps from the surface of the earth, artifically created and resulting from mining operations".

The lower court thus denied the percentage depletion deduction upon the conclusion that statutory depletion is allowable only in case ore is being produced from a natural deposit and that to constitute "income from the property" under Sec. 114 (b) (4), the income must be obtained from contemporaneous production of ore from the natural deposit.

The lower court's restrictive interpretation of these statutes is directly in conflict with this Court's decision in *Herring* v. *Commissioner* and *Douglas* v. *Commissioner*, supra.

In the *Herring* case, *supra*, the words "in the case of mines, oil and gas wells. . .", which now appear in Sec. 23(m) and 114(b)(4) were construed to embrace, as applied to an oil property, land upon which there was no oil well; and the words "income from the property" were construed to embrace a bonus for a mineral lease upon such land as being a payment in advance for oil which might, sometime in the future, be extracted from such land. A similar construction has been repeatedly afforded the word "mines" in these statutes and the propriety of allowing a depletion deduction, in the absence of contemporaneous production of ore from a natural deposit, was recognized and upheld by this Court in the *Douglas* case, *supra*.

The facts in the *Herring* case were these: The taxpayers owned a cattle ranch which they leased in 1926 for mining and operating for oil and gas. Upon execution of the lease in 1926, the taxpayers received $683,793.75 as bonus or advance royalty upon which they claimed a deduction for depletion. At that time there were no wells on the

leased lands and none within three and one-half miles from such lands; and it was not until four years later (1930) that any wells were drilled upon the leased land. In 1926 the taxpayers claimed a percentage depletion deduction upon such bonus, although there was no oil well in existence and no production from any oil well. The applicable revenue act was the Act of 1926, which in Section 214(a)(9) granted

> "in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion ***";

and which in Section 204(c) (2) provided for depletion on the percentage basis as follows:

> "In the case of oil and gas wells the allowance for depletion shall be 27½ percentum of the gross income from the property during the taxable year. ***"

(These provisions of the 1926 Act are identical to the material provisions of Sections I.R.C. 23(m) and 114(b), applicable to the cause at bar, except that the word "mines" is substituted for "oil and gas wells" and the rate is 15%.)

The Commissioner contended that the statutory language which granted a depletion deduction "in the case of . . . oil and gas wells" necessarily excluded a case where there was no well in existence and no production from any well. The Court held that the fact that no well was in existence did not preclude the claimed deduction; that a bonus or advance royalty is *income from the property* and as such is a proper basis upon which to compute a percentage deduction. The Court said:

> "A bonus is not proceeds from the sale of property, but payment in advance for oil and gas to be extracted, and is therefore taxable income. As such it is a part of the *'gross income from the*

property as the phrase is used in Section 204(c)(2) to designate the base for the application of the percentage deduction. From these premises the petitioners argue that the bonus received does not lose its character as income subject to depletion, merely because it happens that in the year of receipt there was no production of the depletable asset.

"The respondent replies that the allowance for depletion is a matter of grace, not of right, and that the act fails to grant any allowance on income such as that there involved. The argument is that in *both* the relevant sections of the act, the statute says 'in the case of *** oil and gas wells' and this expression necessarily excludes a case where no well exists. In support of this asserted statutory exclusion it is urged that a depletion allowance is essentially and exclusively reimbursement for wastage or exhaustion of assets, and Congress could not have meant to permit an allowance in any year in which there was no extraction of oil or gas, and no practical assurance of production in the future. We think these arguments cannot prevail to defeat the petitioner's right to the deduction." (Italics supplied.)

Following this quotation, the opinion sets out the Treasury's prior administrative views as to when and under what circumstances a percentage depletion deduction was allowable in regard to bonus payments and advance royalties, mentions the decisions of the Board of Tax Appeals, and then continues as follows:

"The situation presented by the administrative rulings is this: A bonus is not a receipt from a sale of a capital asset and may not be returned as such; it is income in the year received; if any depletion is to be allowed against the receipt, the allowance must be claimed for the year of re-

ceipt; it cannot be allowed in any later year; if the taxpayer computed depletion upon the basis of cost or March 1, 1913, value he may deduct depletion from a bonus payment, irrespective of the sinking of a well or the production of any oil or gas; if, however, he elects to avail himself of the alternative method of computing deduction at a per cent of gross income, *though the nature of the deduction is unchanged*, he may not have any unless there be production within the taxable year; if the production be but trifling he may take a full percentage deduction upon the entire bonus, however disproportionate the allowance to the actual extraction of oil during the year. To condition the allowance on actual production, however small, or the imminent probability of production, and to deal in refinements as to the degree of probability of future production is in many cases to deny any deduction where the taxpayer elects to compute it under section 204(c)(2) (flat percentage of gross income from the property) and to permit it where he elects to compute it under section 204(c) (on the basis of cost). *But the nature and the purpose of the allowance is the same in both cases, and we find neither statutory authority nor logical justification for withholding it in the one and granting it in the other; much less for making the decision turn upon the circumstance that no production is obtained within the year in which the bonus is paid.*" (Italics supplied.)

As the above quotation clearly states, this Court expressly refused to assign a restricted, technical definition to the words "in the case of * * * oil and gas wells." If the words "oil and gas wells" had been limited to mean a hole drilled into the ground, then as the Commissioner argued, the property was not one as to which the statute granted a depletion deduction. There was no "well" in

the *Herring case;* neither was there any production of oil or gas out of any well. Yet the Court there held:

First, that the owner-lessor of such property was entitled to a depletion deduction as being within the statutory language granting a depletion deduction "in the case of *** oil and gas wells"; and

Second, income received as a bonus for the execution of the oil and gas lease constituted "gross income from the property" within the statutory language prescribing the method of computing percentage depletion, although such income was not obtained through contemporaneous production from the natural deposit.

The rule of *Herring* has been applied in the same way and with the same force to metallic mineral properties — the right to a deduction for depletion "in the case of mines" is not dependent either upon the existence of a "mine" as technically defined to mean an "excavation in the earth" or a "vein lode or deposit of minerals" nor upon concurrent extraction and sale of minerals out of such a "mine" technically defined. This Court applied these principles to the words "in the case of mines" in *Douglas* v. *Commissioner, supra.* In that case the taxpayers were owners of a mine which they leased for a term of years to Republic Steel Company, the lessee undertaking to pay a royalty of 40c per ton for ore removed, and a minimum royalty of $20,000.00 per year for the first five years, and $60,000.00 per year thereafter. The lease was executed in 1929, remaining in effect until terminated in 1937, during all of which years the lessee paid the minimum royalty *but without producing any ore from the mine.* Each lessor took a proper depletion deduction in the respective years the royalties were received by them, 1926 to 1936, inclusive. Although the precise issue in the case was whether the amounts deducted for depletion in such years must be restored to income in 1937 when the lease terminated without any production thereunder, the Court reiterated the principle of the *Herring* case, *supra,* and

definitely held that the right to a depletion deduction is not dependent upon a *concurrent extraction* of minerals from a "mine." The Court said:

> "Deduction is allowed for the exhaustion of the property — the ore mass. Lynch v. Alworth-Stephens Co., 267 U. S. 364, 370. 45 S. Ct. 274, 275, 69 L. Ed. 660. *It may be in step with extraction, where extraction and sale synchronize with payments for the ore or the deduction may be allowed against advance payments of royalties or bonus. The theory of depletion is the same in both cases. In either situation, the depletion deduction is allowed in the ore extracted or expected to be extracted.* Regulations 45, Art. 23 (m) -2 and -10 (a) and (b). Thus the mine owner under Article 23 (m) -10 *is compensated for the use of his mineral reserves in the production of gross income.*" (Italics supplied.)

It is now, and has been since the decision in the *Herring* case, well settled that the owner of an economic interest in a mineral property is entitled to a deduction for depletion upon a bonus or advance royalty even though there is not on the property a "mine" or a "well" as technically defined, and even though there is no income produced by concurrent realization of the proceeds of oil extracted out of the ground or mineral extracted out of a vein lode or mineral deposit. Thus, it is well established that the words "in case of mines, oil and gas wells", as used in both Sections 23(m) and 114 (b) are not restricted to the technical definition of a mine or the technical definition of an oil and gas well as the Court below held. On the contrary, the cited cases clearly demonstrate that an unexcelled and undeveloped mineral property is within the meaning of the word "mines" as used in such sections, and that proceeds can be "income from the property" without being proceeds directly obtained from concurrent or simultaneous extraction of minerals out of the ground.

In the instant case the lower court held that the words "in the case of mines," appearing in Sections 23 (m) and 114(b), are limited to "the vein lode or deposit of minerals" and that "mining thus connotes the removal of minerals from a natural deposit." Such limited and strict interpretations of the words of the statute cannot be reconciled with the above-discussed decisions of this Court. There was no "mining" in *Douglas*; for eight years the taxpayers there received payments while the mine was idle and no ore whatsoever was removed. Yet such payments were held to be income from the property, properly subject to depletion allowance. There was no oil "well" in *Herring* and when the income was received it was not known whether there ever would be an oil "well." Yet the taxpayer was held entitled to a depletion deduction allowed "in the case of oil and gas wells" and the income was "income from the property." In the instant case the income under discussion came directly from ores out of a mine. But because the receipt of income was subsequent to the removal of the ores from the natural deposit, the depletion deduction was denied. This is in direct conflict with the decisions of this Court above discussed.

A bonus or advance royalty is held to be income from the property subject to percentage depletion upon the premise that it is income from possible future production which will deplete the minerals of the property; and the deduction is allowed, despite the fact that such subsequent production may, or may not, materialize. In the instant case, the income from minerals produced from the property was received after the production thereof, but the relationship of the income received to the actual production and physical depletion of the property is much more proximate and direct than in the case of an advance payment. Here the proceeds received are clearly payment for the recovery and sale of minerals earlier produced. As in the case of the advance payment, so it is with the subsequent payment — statutory depletion must be allowed at the time the income is received, else

it is denied entirely. It is immaterial, we submit, that ores produced from a mineral property were held for a time thereon in a dump with a result that income from the recovery of minerals from such ores was realized in a year subsequent to their severance from the natural deposit. Such income, when realized, is nonetheless income from the property subject to depletion within the principles of the *Herring* and *Douglas* cases, *supra*.

II.

Both the petitioners, one as owner and the other as lessee, owned an economic interest in the property and are therefore entitled to a depletion deduction upon the income therefrom, such deduction to be equitably apportioned between them.

No citation of authority is necessary for the proposition that The London Extension Mining Company, as an owner of the mining claims upon which was located the developed American Mine and upon which was located the dump ore in question, possessed the requisite ownership of an economic interest in a mineral property to entitle it to a deduction for depletion under Sec. 23(m).

Chicago Mines Company, as lessee of a part of that property from the owners, likewise possessed the requisite ownership of an economic interest therein. In *Palmer v. Bender*, 287 U. S. 551, 53 S. Ct. 225, 77 L. Ed. 489, this Court established the proposition that the right to a depletion allowance does not depend upon the retention of ownership or any other particular form of legal interest in the mineral content of the land. As to a lessor, the Court said "It is enough if by virtue of the leasing transaction he has retained a right to share in the oil produced. If so, he has an economic interest in the oil, in place, which is depleted by production. Thus we have recently held that the lessor is entitled to a depletion allowance on bonus and royalties, although by the local law ownership of the

minerals, in place, passed from the lessor upon the execution of the lease."

Thus this Court expressly pointed out that ownership of the mineral before removal from the ground is not a prerequisite of an economic interest; on the contrary, the test of an economic interest, as declared in *Palmer* v. *Bender, supra,* is whether the taxpayer has a right to share in the mineral produced. If so, he has an economic interest in the mineral, in place, which is depleted by production. Paraphrasing the words of the decision, it would be said that it is enough if the taxpayer has a right to share in the gold produced. If so, he has an economic interest in the property which is depleted by production. In the instant case, Chicago Mines Company, as a lessee, had a right to share in the gold recovered and produced from the ores obtained out of the mineral property. As such lessee, Chicago Mines Company owned an interest from which its only possibility of profit was dependent solely upon the extraction and sale of the gold from such ores. This Court's recent decision in *Kirby Petroleum Company* v. *Commissioner,* 326 U.S. 599, 66 S. Ct. 409, 90 L. Ed. 343, removes any question as to whether Chicago Mines Company had an economic interest in the mineral property sufficient to entitle it to the depletion deduction. In this case, it was held that a lessor of an oil property had retained an "economic interest" sufficient to support a depletion allowance, although that interest consisted solely of the retained right to share in the lessee-operator's net profits from production, operation and sale. The lessor in this case had retained no "title" or "ownership" of the mineral in the ground, no title or ownership in the mine as it was produced out of the ground, no right to share in the gross receipts upon the sale of the oil; yet, by owning the right to share in net operating income, such taxpayer was held to possess an economic interest entitling it to compute a percentage depletion deduction upon its share of such net profits. The opinion stated:

"Economic interest does not mean title to the oil, in place, but the possibility of profit from that economic interest, dependent solely upon the extraction and sale of the oil."

In the instant case, Chicago Mines does possess the requisite economic interest in the mineral property. Even if the dump ore does not in itself constitute a "mine" under Section 23 (m), which in view of *Herring* and *Douglas* it should, nonetheless the dump ore was still part of the "mine" and was part of the mining claims. Such ore had never been separated from the "mine" or mining claims in ownership. Chicago Mines as lessee of the deposit of ore from the mine located upon the claims was a lessee of a part of the mineral property and hence had the requisite economic interest. Furthermore, under the *Kirby* case, Chicago Mines clearly had such economic interest as is necessary to entitle it to a depletion deduction by virtue of the fact that its possibility of profit from its lease was "dependent solely upon the extraction and sale" of the gold and other mineral content of ores from the property. It is not necessary that Chicago mines have some form of legal ownership of the "mine" nor of the "mining claims"—under *Kirby,* Chicago Mines had an economic interest if it must get its profits from its lease solely from the extraction and sale of the mineral content of ores from the property.

The *Kirby* case further holds that the intent of Section 23(m) and 114(b) was to grant an entire depletion deduction amounting to a full 27½ per cent as to oil properties (15 per cent as to metal properties), and that in case of a division of the income from the property between lessor and lessee, the entire deduction of 15 per cent of the gross income from the property must be divided between the lessor and lessee. This is achieved by permitting and requiring the lessee to compute his deduction as 15 per cent upon the gross income from the property after subtraction of royalties paid to the lessor; and by permitting the lessor to compute his deduction as 15 per

cent upon the royalty received. Such method permits the full deduction of 15 per cent of the gross income from the property — no more and no less. But, if the allocated deduction is allowed to one but not the other, only part of the full 15 per cent of gross income from the property would be allowed and part would be denied. This Court held that the statute contemplates and requires that the entire 15 per cent shall be allowed. Thus, held the Court, where the lessee is entitled to compute his depletion upon gross income reduced by royalties paid to the lessor, the lessor must be allowed the deduction of 15 per cent of the royalties. Conversely, if the lessor is allowed the deduction of 15 per cent of the royalties, the lessee must be allowed the deduction of the balance, which is 15 per cent of gross income reduced by such royalties paid.

The result of this holding in the *Kirby* case and its application to the case at bar is as follows: If London Extension as lessor is entitled to an allowance for percentage depletion upon royalties from the ore dump proceeds, then Chicago Mines, as lessee, must be allowed the balance of the statutory deduction, which is 15% of gross income reduced by such royalties. The effect is to simplify the inquiry into "economic interest." If the *lessor* has the required economic interest and exploits it by leasing for royalty payments, and therefore is entitled to a percentage depletion deduction, then the balance of the statutory deduction must be allowed to the lessee. Chicago Mines, as lessee, does therefore have the required economic interest and is entitled to its share of the statutory deduction.

CONCLUSION

Congress allowed by Sec. 23(m) a deduction for depletion "in the case of mines" and by Sec. 114(B)(4) provided for a depletion deduction in the case of mines to be computed at the rate of 15% of the "income from the property." The deduction is not limited to income realized

from contemporaneous extraction of minerals out of a natural deposit, nor is the deduction confined to the operation of a "mine" as technically defined. On the contrary, the deduction is allowable if the income received it attributable to production of ores from the property, irrespective of whether the income therefrom is realized before or after the act of production. Ore produced and stored remains a part of the property. When such ore is converted into income, depletion of the property occurs; and that conversion produces "income from the property."

In the instant case, each of the petitioners, one as lessor, the other as lessee, had an economic interest in a mineral property and each received income from the extraction and sale of the mineral content from such property. Each should, therefore, under the previous decisions of this Court be entitled to the percentage depletion deduction in computing income subject to tax.

WHEREFORE, the undersigned attorneys for Amicus Curiae, ask that the decisions below be reviewed and reversed.

Respectfully submitted,

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APPENDIX

STATUTORY PROVISIONS

The statutory provisions involved are found in paragraph (m) of Sec. 23, and paragraph (b), sub-paragraphs (4) (A) and (B) of Sec. 114 of the Internal Revenue Code, Title 26 U.S.C.A. Sub-paragraph (4) (B) of paragraph (b) of Sec. 114 was added by Sec. 124 (c) of the Revenue Act of 1943, and is effective as though it were in the revenue laws applicable to all taxable years beginning after December 31, 1931.

Section 23, in force for the taxable periods here involved, insofar as pertinent, is as follows:

> Section 23. Deductions from Gross Income. In computing net income there shall be allowed as deductions: * * *
>
> "(m) Depletion. In the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowances in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *."

Section 114, in force for the taxable periods here involved, insofar as pertinent, is as follows:

> "Section 114. Basis for Depreciation and Depletion. (b) Basis for Depletion.—(4) Percentage Depletion for * * * Metal Mines * * *.
>
> "(A) In general. The allowance for depletion under Sec. 23 (m) shall be * * * in the case of metal mines, * * * 15 per centum * * of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or

royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property * * *."

Section 114 (b) (4) (B), as added by Section 124 (c) of the Revenue Act of 1943, effective as though it had been in the revenue laws applicable to all taxable years beginning after December 31, 1931, so far as pertinent, is as follows:

"(4) (B). Definition of Gross Income from property. As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: * * *; and (iv) in case of lead, zinc, copper, gold, silver or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity), flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 731 and 735."